BEFORE THE PUBLIC SERVICE COMMISSION OF NEBRASKA

IN THE MATTER OF THE APPLICATION OF BLACK HILLS NEBRASKA GAS UTILITY COMPANY, LLC D/B/A BLACK HILLS ENERGY FOR APPROVAL ITS GAS HEDGE AGREEMENT WITH BLACK HILLS UTILITY HOLDINGS, INC.	))))))	Application No. NG-0086

DIRECT TESTIMONY

OF

STEVE SORENSON

ON BEHALF OF

CONSTELLATION NEWENERGY – GAS DIVISION, LLC

FEBRUARY 16, 2016

Q1. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

A1. My name is Steve Sorenson. My business address is 10588 Shea De Lane, Blair, Nebraska 68008.

Q2. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A2. I am employed by CNE Gas Holdings, LLC as Regional Sales Manager for the retail commercial and industrial ("C&I") natural gas customer segment of Constellation NewEnergy – Gas Division, LLC ("CNEG"). CNEG is a wholly-owned indirect subsidiary of Exelon Corporation ("Exelon"). Exelon subsidiaries provide competitive wholesale and retail electricity and gas supply and energy management services nationwide.

Q3. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A3. I have a Bachelor of Business Administration degree from the University of Minnesota – Duluth campus.

Q4. CAN YOU DESCRIBE YOUR EMPLOYMENT HISTORY?

A4. Yes, I have nearly 30 years in the energy industry with experience in both competitive and regulated gas markets. My gas supply experience includes the management of all facets of the supply chain across the wholesale, C&I and mass market segments. My career began in accounting and conservation programs at Northern Minnesota Utilities in 1987. From 1994 until 2001 I was a key account executive with UtiliCorp Energy Delivery in Minnesota, responsible for 35 major industrial and municipal customers. In 2001 I accepted a position as the general manager with AlintaGas LTD in Perth, Western Australia. At AlintaGas I managed a natural gas retail sales organization of 70 employees through the transition from a government-owned utility to a private entity. In 2002 I returned to the US and joined Cornerstone Energy, which was acquired by CNEG five years later, to lead the account manager team in Minnesota. In 2009 I was promoted to regional sales director at CNEG and moved to Omaha.

Q5. WHAT ARE YOUR RESPONSIBILITIES IN YOUR CURRENT POSITION WITH CNEG?

A5. I am responsible for managing a team of eight Business Development Managers ("BDM") who cover Nebraska, Wyoming, Colorado, Iowa, North and South Dakota, Minnesota and Texas. The team has expertise across eight pipelines and services approximately 700 customers in these eight states. The primary duties of the BDM are the acquisition of new customers and the retention of existing customers. Duties include prospecting, meeting with customers, generating proposals, and following up on marketing campaigns. Along with maintaining relationships with customers, the BDM works closely with other internal functional groups including operations, supply, legal/contracts, and billing/collections.

Q6. HAVE YOU PREVIOUSLY TESTIFIED BEFORE A REGULATORY AGENCY?

A6. Yes. I have previously submitted testimony in Colorado, Wyoming and Nebraska in the Black Hills Utility Holdings, Inc./SourceGas Holdings, LLC acquisition dockets. I have also submitted testimony in the pending Black Hills Energy Application for Approval of Participation in Proposed Cost of Service Gas Program ("COSG") and Related Transactions and for Allowance of Cost Recovery and Conditional Request for Waivers, Docket Nos. SPU-2015-0028, WRU-2015-0032-0225, TF-2015-0327, filed with the Iowa Utilities Board on September 30, 2015.

Q7. WHAT DOCUMENTS HAVE YOU REVIEWED IN THE PREPARATION OF YOUR TESTIMONY?

A7. In this docket, I have reviewed the "Application of Black Hills/Nebraska Gas Utility Company, LLC, d/b/a Black Hills Energy, for Approval of its Cost of Service Gas ("COSG") Hedge Agreement With Black Hills Utility Holding, Inc." ("Application") and the related testimony in support thereof filed by Black Hills/Nebraska Gas Utility Company LLC ("Company" or "Black Hills") on September 30, 2015.

Q8. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A8. The primary purpose of my testimony is to state CNEG's concerns if the Application is approved, particularly regarding the absence of a long-term strategy relative to the interrelationship between commodity service obtained from the utility (i.e. Traditional Sales Service or tariff service) and commodity service obtained from third party suppliers (i.e. commodity that is purchased competitively from Competitive Natural Gas Providers.).

Q9. WHAT IS THE EXISTING RELATIONSHIP BETWEEN CNEG AND BLACK HILLS?

A9. Black Hills allows C&I customers to select who will provide their natural gas commodity through gas transportation tariffs. Black Hills offers Rate Schedule EO – Energy Options Program in its tariff which provides transportation service to small commercial or industrial firm customers in Nebraska that use less than 500 therms of gas per day.[1] Transportation service for large/high volume customers is governed by Black Hills Energy's Nebraska Transportation Service Agreement which must be executed prior to

[1] Black Hills/Nebraska Gas Utility Company, LLC, Index No. 15, Section: RS, Sheet 1.

the start of a third party supplier providing natural gas to a customer.[2] A third party supplier is referred to as a Marketer in the Black Hills tariff.[3] CNEG has a Competitive Natural Gas Provider certificate from the Nebraska Public Service Commission and is qualified to serve end-use customers in Nebraska. CNEG is currently a major retailer providing third party supply to Black Hills Energy C&I Sector customers in the state.

Q10. PLEASE EXPLAIN WHAT YOU MEAN BY "THIRD PARTY SUPPLY"?

A10. With the restructuring of the natural gas industry through open access and unbundling requirements ordered by the Federal Energy Regulatory Commission ("FERC") in the 1980's and 1990's, it became common for LDC's such as Black Hills to implement tariffs to facilitate gas transportation services for C&I customers. Large customers could then competitively purchase their natural gas and arrange for its delivery to the utility city gate from parties other than the legacy utility, i.e., third party suppliers such as CNEG. Generally speaking, CNEG and its affiliates buy wholesale supply, arrange pipeline transportation of that supply from where it is produced to be delivered to the utility pipeline interconnect or city gate where the local utility then delivers it to the end-use customers. While restructuring of the natural gas industry began with C&I customers in many locales, it eventually expanded to include residential and small commercial customers. Typically the ability to select a supplier in the C&I segment is called gas transportation service in the industry, while among residential and small commercial customers is it referred to as a choice program or tariff. In Nebraska, Black Hills does

[2] March 2013 memo from Black Hills Energy to All Competitive Natural Gas Providers on Black Hills Energy's system in Nebraska regarding New CNGP/Marketer/Aggregator Procedures in Nebraska.
[3] Black Hills/Nebraska Gas Utility Company, LLC, Index No. 8, Section: GCA, Sheet 4; Index No. 15, Section: RS, Sheets 1 and 2; Index No. 26, Section: GRR, Sheet 3.

not allow residential customers to select their natural gas supplier; residential customers are required to purchase their natural gas commodity from Black Hills.

Q11. WHAT SPECIFIC CONCERNS DO YOU HAVE REGARDING BLACK HILLS' PROPOSED COSG PROGRAM?

A11. Black Hills' Application lacks definition on the terms and conditions regarding the classes of customers that will be included in the COSG program, customer classes excluded from the COSG program, and customers' ability to transfer between those two groups. More specifically, Black Hills seemingly has no long-term plan in place to address customer switching between a transportation service rate class, as served by Competitive Natural Gas Providers, to non-transportation, or tariff-served, rate classes, also known as sales service that Black Hills provides. Since commitments made by Black Hills under the proposed COSG program extend many years, even decades, the ability of customers to move in and out of rate classes served within the COSG program is a critical element for the viability of the program. However, just as critical of a consideration is the adverse consequences to the viability of competitive markets if the requirements of the COSG program result in restriction to customer's freedom to select their preferred commodity provider and instead become captive to monopoly service. This is particularly disconcerting relative to residential customers as Black Hills currently does not allow them to select their natural gas supplier. If the COSG program is implemented there could be a very strong incentive for Black Hills to preclude residential customers from having a choice of their natural gas suppliers for decades into the future.

Q12. PLEASE DESCRIBE THE ABILITY, UNDER THE CURRENT TARIFF, FOR CUSTOMERS TO MOVE BETWEEN SALES SERVICE AND TRANSPORTATION SERVICE.

A12. Currently, the tariff for Rate Schedule – EO, Energy Options Program (Transportation) states "Availability of local gas transportation services under the Energy Options Program is subject to system operational considerations. This Energy Options program is not available to Residential Customers of Black Hills Energy.[4] Also, a Customer must advise Black Hills Energy 30 days in advance in writing when it wishes to terminate services under the Energy Options Program.

While the tariff does not offer additional requirements for moving between sales and transportation services, the Procedure for BHE Customer Converting from Sales to Transportation or Changing Marketers[5] states for the Energy Options (Small Commercial Customers):

> Commercial firm customers are required to take assignment of released firm pipeline capacity. CNGP may add/delete Commercial (i.e., small volume) customers to/from CNGP's Marketer Aggregation pool as follows:
>
> - On NNG/NGPL – April 1 to October 1. Firm capacity is released to CNGP for 5 months: November 1 to March 31. Pursuant to the Non-telemetered Aggregation Agreement, CNGP is obligated to take assignment of firm capacity in an amount set forth in the Agreement as administrated by Company.

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[4] Black Hills/Nebraska Gas Utility Company, LLC, Index No. 15, Section: RS, Sheets 1 and 2.
[5] March 2013 memo from Black Hills Energy to All Competitive Natural Gas Providers on Black Hills Energy's system in Nebraska regarding New CNGP/Marketer/Aggregator Procedures in Nebraska.

- On KMIGT – April 1-30 for a May 1 start data and October 1-31 for a November 1 start date. Firm pipeline capacity is released to CNGP for 12 months. Pursuant to the Non-telemetered Aggregation Agreement, CNGP is obligated to take assignment of firm capacity in an amount set forth in the Agreement as administrated by Company.

For Large (High) Volume Customers the Procedure states:

- CNGP may currently add/delete customers from its marketer aggregation pool year round subject to administration process established by Black Hills Energy for these customers.

Q13. CAN RESIDENTIAL CUSTOMERS CHOOSE BETWEEN TRANSPORTATION AND SALES SERVICE?

A13. As noted above, Black Hills does not permit residential customers to select a natural gas supplier; instead they are captive to the utility for their natural gas. In contrast, SourceGas Distribution, LLC ("SourceGas") does allow supplier choice among its residential customers. The Nebraska Public Service Commission recently approved the acquisition of SourceGas by Black Hills Holding Company on January 26, 2016, and Black Hills has indicated its desire to eventually expand its COSG program to SourceGas.[6] While expansion requires Commission approval at that juncture, I am concerned the COSG program may have a chilling impact on residential customer choice expansion within Black Hills service as well as provide an incentive for future limitations being placed on existing SourceGas Gas Choice customers.

[6] BHC Analyst Day Transcript, October 8, 2015, p. 9 (Bennett Exhibit SB-2).

Q14. WHAT IS THE POTENTIAL NEGATIVE EFFECT OF HAVING CUSTOMERS SWITCHING FROM TRANSPORTATION TO SALES SERVICE UNDER THE COSG PROGRAM?

A14. If customers can readily switch between transportation service provided through a Competitive Natural Gas Provider and Black Hills' tariff service under the COSG program, then the significant volumes in or out of customer classes that are served through the COSG program could create significant disruptions to the COSG program. On the other hand, establishing greater restrictions on switching between transport and tariff service than what is currently in place, in an attempt to mitigate the disruptive effect of customers switching over the long-term under the COSG program, could result in fatal disruption to Nebraska's competitive natural gas market. The ability to switch could result in the COSG program's anticipated demand disappearing while contractual obligations remain and yet, tightening the switching rules to prevent reasonable movement and choice will disrupt the competitive process by making it a less desirable market for customers and suppliers.

In addition, competitive suppliers will not be able to appropriately commit to long-term pipeline capacity, storage, services and other supply options to benefit the customers they serve due to the unpredictability of these customers resulting from their ability to move between rate classes annually. Although customers may switch between services currently, the COSG Program prices may result in prices being more out of sync with market prices more often than they are now, thus resulting in more unpredictability with respect to customer switching year-to-year. Therefore, CNEG is concerned that in the future, Black Hills may be incentivized to restrict the movement of customers in order to meet its obligations under the COSG program.

Q15. PLEASE EXPLAIN HOW THE COSG AGREEMENT, AS PROPOSED, MAY INCENTIVIZE THE COMPANY TO LIMIT OR RESTRICT CUSTOMERS ABILITY TO SWITCH BETWEEN TARIFF CLASSES?

A15. Under the proposed COSG Program, each utility is responsible for incorporating its percentage share of costs (or credits), which is based on the utility's anticipated "hedge quantity" (utility's hedge target /aggregate hedge target multiplied by quantity of COSGCO produced gas), into its rates via its respective PGA/GCA/ECA.[7] In accordance with section 3.2 of the COSG Agreement, a utility's "hedge target" is to be determined based on its anticipated annual firm demand.[8] Additionally, Black Hills' long-term drilling plan will be based on the utilities' aggregate "hedge target."[9] In the event a BHE utility (or several BHE utilities) experiences a decrease to its anticipated annual firm demand, the utility will nevertheless be responsible for its full share of the hedge costs (or credits) charged to it under its originally anticipated hedge quantity.[10] Thus, while gas supply demand subject to the COSG Program may decrease for a given utility, the potential hedge costs chargeable to that utility would remain the same. In this scenario, the utility—or more accurately the utility's customers—would bear a disproportionate share of the costs of the Program (i.e., percentage share/costs is greater than actual demand) that must be passed through its PGA/GCA/ECA, and is also thereby exposed to an additional level of risk. While the COSG Agreement contemplates Black Hills Utility

[7] BHE Witness Kilpatrick Direct, Attachment CK-3; *see also*, COSG Agreement, Sections 5.2 and 5.3.
[8] *See also*, BHE Witness Vancas Direct, p.17.
[9] COSG Agreement, Section 4.1.
[10] COSG Agreement, Section 3.4.

Holdings ("BHUH") accommodating an adjustment to a utility's hedge target and associated potential hedge cost liability should its demand decrease (but only if the decrease is greater than 10%), it does not guarantee that the utility will be released from its responsibility for its percentage share of the potential hedge costs.[11] Such a provision appears to be designed to ensure the viability of the COSG Program should one utility experience a significant shift away from its annual firm demand, such as experiencing a loss of large industrial firm customers from tariff-service as an example. This provision also appears to be designed to protect the long-term commitment of the Company's drilling plan and its dependency on a guaranteed steady flow of capital from the COSG Program. If sustained, a decrease in firm demand of one or several utilities could not only have a significant impact on the viability of the COSG Program but could also adversely impact Black Hills' ability to cover its contractual commitments undertaken pursuant the COSG Program. The pressures caused by a decrease in anticipated firm demand, therefore, may lead Black Hills to seek to limit or prevent customers' ability to switch back to transportation tariffs, to the extent loss of tariff-served customers would further decrease annual firm demand, in order to lessen utility and ratepayer exposure to additional costs and risks. In other words, the Company may be inclined to limit or prevent customer choice.

Ultimately some suppliers may choose to leave Nebraska completely due to this risk which would eventually reduce the number of choices for customers.

Q16. IS CNEG CONCERNED THAT THIS PROCEEDING COULD AFFECT ITS TRANSPORTATION OF NATURAL GAS?

[11] *Ibid*.

A16. Yes. The lack of clarity and detail around the breadth and depth of the COSG program makes it unclear how it could impact customers in the future. This could negatively impact CNEG's short- and long-term business strategies and growth opportunities. It could also impact existing contractual agreements that are in place with customers, contracts that were entered into by CNEG with the existing service regime in Nebraska well in hand, and may otherwise set in motion adverse impacts on the transportation program subsequent to the approval of the COSG program.

Q17. WHY DO YOU BELIEVE THE COST OF SERVICE GAS PROGRAM CONFLICTS WITH A COMPETITIVE MARKETPLACE?

A17. If Black Hills' premise is true and the COSG program allows Black Hills to offer customers long-term, stable pricing that is in fact lower than market prices, it will be extremely challenging for competitive retail suppliers to offer products and services that are competitive against a below-market utility price. Any time a non-level playing field exists, for example if utility tariff rates are artificially lower than market pricing, then it is difficult for competitive suppliers to either enter or remain in that market area.

Although protection of retail suppliers against below market prices is not, per se, the concern or responsibility of the Commission, the Commission should focus on the overall best market structure to minimize ratepayer price and risk. What should be of particular concern to this Commission is that long-term market price predictions for natural gas are subject to greater uncertainty the farther into the future they are made. While providing natural gas at less than market prices might be possible as market prices swing up and down in the short term, no prudent business person in a competitive market could guarantee pricing below the market for the long term. While distribution service is deemed a monopoly service and is regulated accordingly, the production and drilling of the natural gas commodity is for, all intents and purposes, a competitive business and subject to competitive dynamics as such. If a natural gas producer had high confidence that its future costs were very likely to be notably lower than future natural gas market prices, there would be willingness to take the risk associated with that market advantage for its own benefit, with or without a guaranteed profit. Black Hills' witness testimony filed in support of its Application, as explained at length in CNEG witness Bennett's testimony, indicates that Black Hills is not highly confident that its future E&P (i.e., Black Hills Exploration & Production ("BHEP")) costs will be notably lower than future natural gas prices. Thus, it is not willing to invest in assets or drilling without the COSG program.[12] Further, since the future market price of natural gas is uncertain, and Black Hills is an entity with both traditionally regulated and non-regulated affiliates, the Commission should be concerned that the COSG program provides the company with a mechanism to subsidize its non-regulated affiliates, particularly BHEP, with Nebraska ratepayer funds collected through the COSG program.

Q18. HOW HAS THIS COMMISSION HISTORICALLY TREATED RATEPAYERS SUBSIDIZING NON-REGULATED UTILITY ACTIVITIES?

A18. It is my understanding that the Nebraska Administrative Code includes rules intended to protect ratepayers from bearing the unreasonable or excess costs of unregulated affiliate activities that a regulated utility may attempt to include in its rates. Under 291 Nebraska Administrative Code Ch. 9, Rules 005.07A-B, the utility has the burden of demonstrating that the amounts paid to an affiliate are "prudently incurred" and "approximate the

[12] Direct Testimony of Ivan Vancas, pgs 22-24 and T. Arron Carr, pg 8.

market value of service to [the utility].” Costs that are not prudently incurred or that do not approximate market value are not to be recovered by the utility.

Q19. ACCORDING TO YOUR UNDERSTANDING, HOW DO THESE RULES IMPLICATE BLACK HILLS' PROPOSAL?

A19. While I am not an attorney, my concern is that Black Hills is asking the Board to approve a program that could, by its very terms, result in the subsidization of certain Black Hills' unregulated E&P affiliate operations (i.e., BHEP), which are not currently included in Black Hills' rate base, with Nebraska ratepayer funds. As explained in CNEG witness Bennett's testimony, it is clear that the Company is intending to involve BHEP heavily in the COSG Program, including bringing in currently owned BHEP reserve assets into the Program. BHEP operations currently present such a significant risk to the Company that it would rather fund its operations through the COSG Program than invest further in it with its own investor-backed capital, as CNEG witness Bennett explains. In the event BHEP costs exceed the market value of gas (i.e., it is unprofitable), as is currently the case, its excess costs will be passed on to Nebraska ratepayers in the form of a “hedge cost.” This hedge cost, by definition, is a cost passed on to Nebraska ratepayers via the PGA that does not approximate market value. To the extent other non-affiliate costs are included in the hedge cost (e.g., drilling, materials, royalties, taxes, etc.), those are costs for which the Black Hills family of operations are currently ultimately responsible in the absence of the COSG Program. Moreover, the layers of unregulated affiliate/non-affiliate transactions and costs will make it difficult for the Commission to analyze whether costs proposed to be passed through the PGA were prudently incurred. This is especially true given the aggressive timeline for review set by the Company. Through the COSG Program, Black Hills is essentially asking this Board to neutralize BHEP's risk in the competitive exploration and production market by guaranteeing it earns a profit on its operations whether or not it can deliver natural gas profitably. Subsidizing Black Hills' unregulated operations in this manner would be unfair to competitive suppliers and is not in the Nebraska ratepayers' best interests.

Q20. SHOULD THE COMMMISSION WAIVE 291 NEB. ADMIN. CODE, CH. 9 §005.07 AND APPROVE THE COSG PROGRAM?

A20. No. Subsidizing Black Hills affiliates, particularly BHEP, with Nebraska ratepayer funds is not in the public interest. The Commission should be concerned about cross-subsidizing an unregulated utility, especially one that has experienced significant impairments for some time now as pointed out in CNEG witness Bennett's testimony, with captive customer funds.

Q21. WHAT IS CNEG'S VIEW CONCERNING COMPETITIVE MARKETS?

A21. The forces of competition bring discipline into the market and encourage a low price environment over the long-term. This is especially true when compared to a monopoly system with few, if any, alternatives for consumers and only a regulatory process to govern fairness and prudence. Further, as the impacts of shale discoveries and hydraulic fracturing have shown, the market is not static, but is rather a dynamic environment. Market changes can occur quickly in either direction. Thus, if over time the COSG program results in higher prices than the current market prices, ratepayers will by necessity absorb above market costs. Since the future is uncertain, a COSG program places future price risk clearly on the ratepayer, whereas the competitive market offers consumers control over price risk through an array of products and services available in the market.

Q22. WHY SHOULD THE COMMISSION BE CONCERNED WHETHER APPROVAL OF THE COSG PROGRAM IMPACTS THE LEVEL OF COMPETITIVE OPTIONS FOR NEBRASKA RATEPAYERS?

A22. Exelon and its subsidiaries, including CNEG, offer wholesale and retail electric and natural gas services throughout much of the US. Exelon is one of the nation's leading competitive energy providers and is a strong supporter of competitive markets due to their superior ability to deliver choice, innovation and value for customers. The bottom line value proposition is rather straightforward: it is our experience that competitive markets function better than regulated markets. Over the past decade we have seen new technologies in the gas producing business allow the production of gas from regions that were once cost-prohibitive. New gas from shale has increased the supply of natural gas beyond what was thought reasonable not all that long ago and resulted in substantial downward pressure on natural gas prices. We have seen large natural gas power plants compete directly against coal and nuclear production. No one knows what the natural gas industry will look like a decade from now, but what we do know is that the forces of competition and the reaction to market prices spurred innovation in the industry resulting in new technologies in use today that were not commonplace a decade or two ago. My fear is that the approval of a COSG program removes incentives to become more efficient, thwarts innovation and improvements in the industry, and instead locks in current technology which is the opposite of progress.

The future health of competitive markets should be of concern to the Commission as, according to the Natural Gas Nebraska Energy Statistics from the Nebraska Energy Office as reported on the Official Nebraska Government Website, over 91,000 customers in the state have opted to select a Certified Natural Gas Provider to supply their natural gas. This illustrates the value—one that has been in place for industrial customers in the state since the late 1980s—that Nebraska businesses place on having the freedom to choose their supplier for natural gas.[13]

Q23. WHAT ARE YOUR RECOMMENDATIONS FOR THIS PROCEEDING?

A23. Black Hills seeks approval of its COSG program. While the COSG program is not intended to directly impact natural gas customers served through the competitive market in Nebraska, uncertainty about the program and future market prices opens the door for unintended and unwanted consequences to Nebraska customers. For this reason, along with the reasons articulated in the testimony of Mr. Stephen Bennett, I urge the Commission to reject the COSG program as proposed by Black Hills.

Q24. DOES THIS CONCLUDE YOUR TESTIMONY?

A24. Yes, reserving the right to comment further on statement and submissions submitted to the Commission after this date.

[13] Nebraska Natural Gas Customers updated January 7, 2015, Nebraska Energy Office, Official Nebraska Government website.